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**PACIFIC**  **TELESIS**  
Group - Washington

December 30, 1993

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William F. Caton  
Acting Secretary  
Federal Communications Commission  
Mail Stop 1170  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

Dear Mr. Caton:

Re: *RM 8388 - Inquiry Into Policies and Programs to Assure Universal Telephone Service  
in a Competitive Market Environment*

On behalf of Pacific Bell and Nevada Bell, please find enclosed an original and six copies of their "Reply Comments" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,

*William F. Adler*  
*KAP*

Enclosures

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

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In the Matter of )

Inquiry into Policies and Programs )  
to Assure Universal Telephone )  
Service in a Competitive Market )  
Environment )

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OFFICE OF THE SECRETARY

RM 8388

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REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL

Pursuant to the Public Notice dated November 16, 1993, Pacific Bell and Nevada Bell hereby file reply comments on the petition of MFS Communications Co., Inc. ("MFS") for a Notice of Inquiry ("NOI") and En Banc Hearing with respect to universal service issues.

We support in principle MFS's request for a proceeding to identify the subsidies implicit in existing telecommunications pricing and to determine what subsidies, if any, should take their place. Today's rules incorporate a vast and intricate system of subsidies that was premised on the absence of local exchange competition and on a definition of "universal service" that has not been revisited since the Great Depression. The comments display wide differences of opinion on such basic questions as what universal service is or should be, what a subsidy is, and the fairest way to eliminate subsidies or achieve universal service. It is, in short, even more daunting than MFS lets on. That should not deter the Commission from taking

action. The Commission's own decisions have made action critical.

There would be no point in responding to every contention made in the comments with which we disagree. We think reform should proceed in accordance with the following principles.

1. Expanded interconnection for switched transport and special access, open network architecture, exponential declines in the costs of both switching and mass transport technologies, the explosive growth of cellular telephone service and the rapid emergence of other alternatives to landline service such as PCS, and the smashing of boundaries between traditionally separate businesses and types of common carriage (such as radio, wireline, and cable TV), have made nearly every service we provide subject to competition now or in the immediate future. The monopoly premise for the current rules is obsolete.

The nature of our burden is different from the ones borne by most businesses. Millions of customers will continue to rely on us as the carrier of last resort. Our provision of service to those customers has been kept afloat by revenues from the very services that are now subject to competition. As those revenues are threatened, the cost of remaining on the network for everyone else rises. It is not just a matter for LEC shareowners to worry about.

2. The current rules have done a good job in the past of ensuring the availability of basic telephone service to nearly everyone who wants it. But left unaltered, the current system of

subsidies, non-cost-based rates, and efficiency penalties (such as the price cap sharing mechanism) will be a future disincentive to the universal deployment of more advanced services such as broadband. If the rules continue to handicap us or any other providers, the network of the future may still be built but it will not be built efficiently or ubiquitously. Consumers will pay billions more in rates for the network of the future than they have to, and some consumers may not have access to it at all.

3. In markets where no one provider has market power, regulation is not only unjustified but almost always contrary to the public interest. The only legal restrictions that are justified in competitive markets are the principles of the antitrust laws. Practically nothing that we provide is an essential facility anymore. Wisely, the antitrust laws generally do not control behavior by prematurely intervening in markets and handicapping some market participants but not others. It should come as no surprise that erecting redundant "safeguards" on the most efficient carriers results in huge and unjustified efficiency losses that are borne by consumers. The Commission's greatest successes have resulted from decisions to refrain from regulating competitive businesses, such as CPE, cellular, and LEC billing and collection service. In every one of these instances costs fell, prices fell, and consumer choices increased, all without any apparent anticompetitive activities by the incumbent players.

"Regulated competition" is an oxymoron. Regulation mimics the political process, not the market process. It is a forum in which producers and distributors are well represented but consumers are not. Regulation does not foster competition -- only, at times, a plethora of inefficient competitors, and that is not the same thing.

4. The current systems of separations and subsidies cannot be sustained under competition. Our access prices are not cost-based now, and the current rules do not allow us to move them toward cost anytime soon. The end user common line charge (EUCL) reduced the subsidy on transport somewhat, but a huge subsidy remains. In addition, the separations rules overstate the interstate portion of our fixed costs -- another way to avoid recovering loop costs in loop charges.

The subsidies embedded in our rates are the eight hundred pound gorilla of "managed competition." They are far too massive to be absorbed by shareholders (and regardless of size, there is no good reason shareholders should have to absorb them). Like consumers, shareholders have choices and will invest their money elsewhere. No new business opportunity will offset the loss of present subsidies. They are not attributable to plant that is no longer necessary or useful or to wrongheaded investment decisions. They are costs that regulators obligated us to incur to provide universal service.

If the Commission tries to "manage" such subsidies as it did before customers had choices, it will continue to encourage bypass and therefore threaten universal service by increasing the

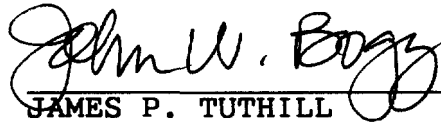
cost burden on customers who remain. If the LECs are not allowed to recover their joint and common costs in a rational and efficient way, the subsidies will be halted in the most destabilizing way possible: customers with choices will just stop buying access services that are laden with subsidies, implicit or explicit. It will be tempting to deal only with the explicit subsidies. That is flawed because it ignores the way that markets operate. The real legacy of our universal service obligations -- the subsidy that customers avoid paying when they have a choice -- is not just explicit support flows but the entire contribution above long-run incremental cost from services such as transport to fixed costs such as the loop. Buyers with competitive choices will avoid services that are priced above the market whether the reason for the above-market price is an implicit or an explicit subsidy.

The following roadmap suggests itself. The Commission should proceed by means of a Notice of Inquiry, clarifying the issues to be decided in a subsequent rulemaking, but it should proceed rapidly. Since reform of the separations rules will be required, a joint board will have to be convened. Reform of the access charge rules that keep rates for competitive services well above long-run incremental costs should not await separations

reform, however. It is a short-term imperative to preserve universal service as it is.

Respectfully submitted,

PACIFIC BELL  
NEVADA BELL

A handwritten signature in cursive script, appearing to read "John W. Boggy", is written over a horizontal line.

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Their Attorneys

Date: December 30, 1993

CERTIFICATE OF SERVICE

I, D. E. Van Laak, hereby certify that copies of the foregoing "REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL" re RM 8388 Petition of MFS Communications for a NOI and En Banc Hearings, were served by hand or by first-class United States mail, postage prepaid, upon the parties appearing on the attached service list this 30th day of December, 1993.

By:   
D. E. Van Laak

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RM 8388  
0559B



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